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American Society of Women Accountants

The Woman CPA

WINTER 1991

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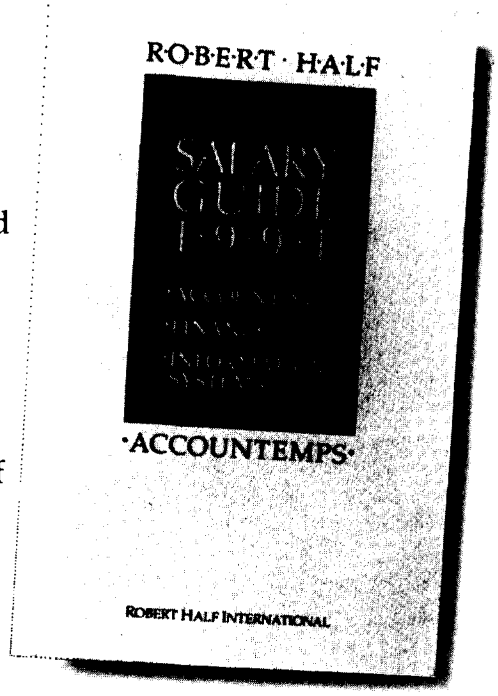

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ARTICLES

DEPARTMENTS

Editorial

This year's JAM in Washington, D.C. was outstanding. We had a record attendance and many exciting programs. We opened like "Star Wars" with innovative video introductions that set the tone for the rest of the meeting. This was truly a JAM to remember. Mark your calendars for September 11-14, 1991 to join us in Chicago. The officers of your organizations are busy planning another high quality conference.

We often forget the amount of time, effort, and sheer frustration that goes into planning and implementing a national conference. Many professionals are contributing large blocks of time and energy toward enhancing the opportunities available for women in accounting and we all owe them our heartfelt appreciation. Many people are also working to make The Woman CPA a better journal for the members.

With the first issue of the new year, we are adding five new department editors: Ann Pushkin for Gender Issues, Mary Alice Seville for Not-For-Profit, Lisa Martin for International, Teresa Thamer for Tax and Chris Fugate for Book Reviews. We deeply appreciate the services of our outgoing editors, Yvonne Braune, Dahli Gray, Karen Hooks, Cheri O'Neil, and Jewell Shane, who have served The Woman CPA well. We welcome our incoming editors.

Ann Pushkin is an Associate Professor of Accounting at West Virginia University. Her primary teaching and research area is auditing. She was the first Chairman of the Gender Issues Section of the American Accounting Association. In addition, Ann has served as a reviewer for our Gender Issues Department since its inception.

Lisa Martin is currently an Associate Professor of Accounting at Morehouse College in Atlanta, Georgia. Born in Germany, she has a strong international background. For ten years, she was in charge of the International Section of Scripto Corporation, a large multinational company.

Chris Fugate is the Controller at The Children's Heart Center in Atlanta, Georgia. She was formerly with Medicaid Hospital Audits. Chris followed a path common to many women and left the work force for several years to care for two small children. She has written several of our recent book reviews.

Mary Alice Seville is an Associate Professor at Oregon State University where she teaches Not-For-Profit accounting. She also serves as Treasurer of The Educational Foundation of AWSCPA-ASWA.

Teresa (Terry) Thamer formerly had her own public accounting practice where she was heavily involved in taxes. She is now teaching accounting at Embry Riddle Aeronautical in Daytona, Florida.

All of our incoming editors are strong professionals who will bring new perspectives to The Woman CPA. Only with the talents of many people can we produce a quality journal that will be of interest to our readers.

Betty Brown

Financial Counseling:

Analysis of an Underrated Fringe Benefit

By John M. Strefeler and Jeanne M. Hilton

Fringe benefits are an important component of employee compensation, as evidenced by the increase in these benefits during the last half of the twentieth century. According to the U.S. Chamber of Commerce, fringe benefits accounted for only 3% of payroll in 1929, but grew to 26% in 1971 and composed 34% of payroll in 1984 (Lissy, May 1986, p. 70). The growth of fringe benefits has been manifested not only in the absolute size of these benefits, but also in their increased variety. Noncash compensation such as child care facilities, drug and alcohol counseling, and physical fitness programs have become increasingly available to the American workforce. Sophistication and flexibility are frequently introduced in the form of cafeteria plans, whereby employees are permitted to "roll their own" by choosing the benefits they wish from an available menu.

Financial planning is one of the most desired executive perks and is one which is increasingly being offered (Breitbard, 1984, p. 66). At the same time, personal financial counseling for the rank-and-file employee appears to be a forgotten and severely underutilized benefit.

The purposes of this article are: to distinguish between personal financial planning and personal financial counseling, to establish the need for personal financial counseling as a part of the employee benefit package, to indicate the relationship of personal financial counseling to productivity (e.g., benefits to the employer), and to suggest guidelines for developing a financial counseling program.

Financial Counseling Versus Financial Planning

While financial planning and financial counseling are frequently regarded as synonymous terms, it is important that the functions of the counselor be distinguished from those of the planner. Financial planners and counselors provide different professional services and address different types of client problems and objectives (Mason and Poduska, 1986, pp. 142-147).

The common link between personal financial planners and personal financial counselors is that competency in each field involves helping clients to successfully gain control of their financial affairs. While financial planners are oriented toward upper-income clients who require sophisticated and specialized economic planning, financial counselors focus upon short-term problem solving with clients primarily in the middle-or lower-income classes (although upper-income families are not immune to these problems). Thus, the services of a financial counselor are more basic and general than those of a financial planner and are as much focused on social, managerial, and educational processes as on economics. Such services would be more directed toward the rank-and-file employee.

The General Case for Personal Financial Counseling

The trend toward employee wellness packages includes counseling programs in substance abuse, training programs for parents, and physical fitness programs (Lissy, March 1986, pp. 70-74). Economic security through personal financial fitness is one aspect of such employee wellness, with the explosive growth of personal financial planning services providing striking evidence of its importance. Ironically, however, financial counseling is a service which is difficult to deliver through the marketplace. Those who need it the most can least afford to pay for the service.

Stress engendered by financial difficulties can cause many repercussions which impact upon the level of one's work performance.

The business community has developed a growing awareness of the impact of family problems on worker productivity; increasingly it is responding to the personal and family needs of its work force by promoting employee fitness programs. Such efforts to deal with the causes of stress are consistent with the recommendation of Senatra, whose study endorsed eliminating the cause over coping with the effects in the area of job stress (1988, p. 15). Counseling programs in drug and alcohol abuse have become more common as a means of promoting efficiency. Parent training programs and physical fitness programs are also emerging. It seems only natural that financial fitness programs be added to social and physical fitness programs as a part of the comprehensive employee wellness package.

The economic environment in which employees must operate adds support to the need to include fiscal health as a part of overall wellness programs. Changes in the contemporary American economy indicate that increasingly complex financial decisions must be made by the average individual. For example, studies show that private fringe benefits are increasing at a faster pace than public benefits and that current benefits (such as health care) have decreased while future benefits (such as retirement) have increased (Chen, 1981, pp. 5,6). These trends provide evidence that responsibility for personal well-being is shifting back to the individual.

Cost-sharing by employees with regard to fringe benefits is another example of a trend calling for personal budgeting skills. This may take the form of a splitting of the original cost of a fringe benefit, such as the premium for life insurance protection. It may also be exhibited in benefit adjustments, as when the deductible is increased on a health insurance policy. In either situation, the cost-sharing represents an impact on the cash available for other purposes and thus is an additional factor which must be taken into account in family financial management.

Cost/Benefit Analysis

Of all fringe benefits, personal financial counseling is one of the most flexible in the sense that it can benefit all employees, regardless of their circumstances. It has the advantage of providing benefits to employees at a lower cost to the employer than employees would have to pay to obtain them on their own.

The benefits to the employer are derived from reducing employee stress. This is significant since severe stress may lead to problems such as physical illness (Smith, Stewart, and Everly, 1989, p. 26). "Financial counselors understand that financial problems are often both the cause and the effect of other problems are often both the cause and the effect of other problems in the household, such as depression, alcoholism, suicide, and divorce" (Mason and Poduska, 1986, p. 145). Stress engendered by financial difficulties can cause many repercussions which impact upon the level of one's work performance. These include poor concentration, fatigue, depression, accident-proneness, headaches, erratic behavior, alcoholism, drug addiction, stroke, and heart disease (Figler, 1980, p. 23). Any program which reduces employee stress levels, by contrast, makes more energy available for job productivity.

We advocate financial counseling programs as a means of building employer goodwill and raising employee morale.

We advocate financial counseling programs as a means of building employer goodwill and raising employee morale. It should be valued not only by the direct participants who benefit, but also by other employees who will benefit indirectly from financial assistance which is provided to their co-workers. Since problems such as employee theft, work related accidents, interpersonal conflict, and lowered productivity are often the result of low employee morale, everyone benefits when morale is improved.

Tangible results from a program of personal financial counseling may take many forms. These include increased productivity, reduced white collar crime, reduced turnover, and reduced absenteeism.

Increasing the general satisfaction of an employee by relieving financial stress should reduce turnover, which would mean retaining the benefits of the substantial training invested in that worker. Recruiting costs and unemployment insurance costs are expenses which could be minimized through retention of workers who would otherwise leave. The greatest benefit, however, might well be realized in the reduction of white collar crime. These crimes, principally embezzlement and employee theft, can be a significant cost of doing business.

Law enforcement professionals emphasize that crimes occur when there is both a motive and an opportunity. Prevention of white collar crime has historically focused on reduction of opportunity, with accountants attending to the implementation and operation of appropriate systems of internal control. Motivation, by contrast, is largely ignored except for the use of limited procedures, such as polygraph tests, which attempt to identify personal predisposition. Public concern for preservation of the individual's right to privacy discourages such approaches.

"People who feel that money, goods, and opportunities are denied them or placed beyond their reach by economic conditions more easily rationalize illegal acts which relieve their problems or resolve their conflicts"

Who are the white collar criminals? "People who feel that money, goods, and opportunities are denied them or placed beyond their reach by economic conditions more easily rationalize illegal acts which relieve their problems or resolve their conflicts" (Romney, Albrecht and Cherrington, 1980, p. 52). Therefore, motivation to commit white collar crime can be curbed by relieving the situational pressures which produce these conditions. Financial counselors may be able to identify causative issues such as excessive debt, unrealistic personal or family expectations, speculative financial investment, or destructive habits involving gambling, alcohol, or drugs. Counselors may then deal with those problems for which they have the professional skill and make professional referrals for problems beyond their areas of expertise.

The benefits that a particular enterprise will derive from a program of financial counseling will depend on numerous factors, including the composition and demographic characteristics of the employees. Indicators of need for a program would include the number of sick days compared to the national average, evidence of employee theft from the business, and other evidence of low employee morale. Identification of the benefits which may be derived may be more obvious if a needs assessment analysis and pilot program are instituted for employees.

Likewise, cost will vary from company to company based upon the degree of need and use by a particular set of employees. Cost will also vary over time within the same firm due to such factors as the state of the economy. The relative burden of the cost will differ among firms based upon size and labor intensity, with smaller firms having a greater impact because of he threshold of fixed costs involved to maintain a minimum program.

Guidelines for Developing a Financial Counseling Program

Several issues need to be addressed in implementing a financial counseling program. These issues include choices between individual and group counseling and internal versus external programs. Other concerns include choices between individual and group counseling and internal versus external programs. Other concerns include selling the program to employees, providing confidentiality and procuring feedback on the effectiveness of the program.

If the scope of an employee financial counseling program is to be limited to group counseling, then topic selection for the seminar sessions becomes critical. The seminars must, of course, focus upon areas of interest which are of concern to a broad-based cross section of employees. For example, a session on budgeting to live on a pension would probably not be appealing to a work force largely composed of members under age 35.

It is also important that seminar leaders take care not to preach or intimidate. They need to avoid giving a technical presentation of intricate rules and regulations since the participants are not expected to achieve technical expertise. Rather, there should be a premium on practical advice that is understandable and can be quickly implemented. The seminar leader will need to target upon the "how to" aspects of the subject in order to promote confidence and a sense of independence on the part of the participants. Otherwise, stress and confusion may result.

Even if a seminar format is employed, it is still a good idea to provide individual follow-up sessions. These permit participants to clear up misconceptions and points of confusion, as well as allow employees to ask questions which are tailored to their own circumstances. This step may be very important in helping them to implement the concepts of the seminars. Coordination with the personnel office could facilitate paperwork matters, such as changing W-4 exemptions claimed for withholding or altering credit union allocations. If necessary, the individualized sessions could be limited (e.g., 2 or 3 hours per employee) or extended individualized sessions could be offered to the employee with a co-payment financial arrangement.

Personal financial counseling may be offered either internally (on-site by personnel in employee status) or externally (through an arrangement with an independent contractor). A possible compromise may be to have an independent contractor come to the business site.

One of several advantages of an internal financial counseling program is that the program can be tailored to the needs of the employees and the desires of the company. A second advantage is the ease of access to the services for the employees. An external program, by contrast, may

Rather, there should be a premium on practical advice that is understandable and can be quickly implemented.

discourage participation because of the inconvenience of traveling to a location remote from the business.

A third advantage is that an internal program provides tangible evidence of the commitment of the company to the program. Again, this factor may induce greater participation by the employees. A caution about an external program, however noble the motive, is that unless the program is carefully promoted, there may be a low participation rate due to lack of perceived employer commitment.

Some employees may feel more secure about the confidentiality of their counseling sessions if the counselor is not a salaried employee of the company.

Careful consideration might be given to having an internal program with contracted independent counselors. Some employees may feel more secure about the confidentiality of their counseling sessions if the counselor is not a salaried employee of the company.

Selling the Program

Once the company has identified the benefits which it wishes to provide and has designed the structure of the program, proper communication becomes critical. This means, for example, that program publicity should not offend the individual's sense of personal dignity by characterizing participants as people who are unable to cope with problems.

Also, the operation of the plan needs to be explained in a fashion which encourages participation. Initial notification should perhaps be in the form of a detailed letter to each employee including an example of the steps in the financial counseling process. This letter would be followed by group meetings to answer questions and to provide additional detailed orientation. Finally, seminars and individual meetings would be scheduled to conduct the actual counseling.

One problem which you need to be sensitive to when implementing a financial counseling program is that employees may be hesitant to share financial information in an employer-sponsored program. It is imperative to assure confidentiality. While the program is provided through company sponsorship and any billing for services would be sent to the company, the details regarding services rendered should not be specified to the employer. By contrast, the employee should receive memorandum notification which delineates both the work performed and the cost to the firm.

Evaluating the Program

It may be speculated that personal financial counseling is an underutilized fringe benefit because the benefits are difficult to document. Where formal analysis of the effect of financial counseling on productivity is not possible, it may still be useful to obtain feedback from participating employees. Immediate feedback can be solicited at the end of a seminar or counseling session by having the participant(s) complete an evaluation form. Several months later, a followup questionnaire could be used to inquire as to the continued results of program activities.

Concluding Thoughts

Businesses need to consider the potential of personal financial counseling as a cost-effective fringe benefit. As with other fringe benefits, organizational goals and specific needs determine the existence and nature of any company-sponsored personal financial counseling program.

Personal financial counseling, like personal financial planning, is a fringe benefit which enhances other fringe benefits, especially in the context of a cafeteria plan. For participating employees, the actual or perceived value of the cash and noncash compensation may substantially outweigh the additional employer expense. For the employer, providing financial counseling as a part of the benefit package may improve employee morale and pay satisfaction, thereby leading to enhanced productivity and a decline in personnel turnover.

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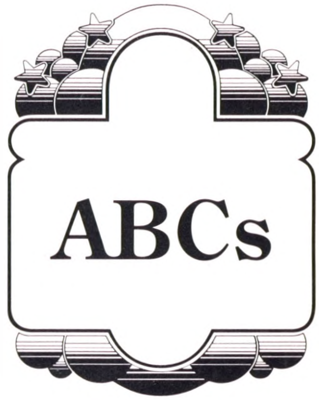
See Dick and Jane Get Creative:

An Introduction to Some Innovative Financial Instruments

By Susan C. Borkowski



CATs, LYONs, TIGRs, CMOs, STRIPs, CIBs, ABCs — Today's accountants aren't sure whether they have gone to the zoo or ordered a bowl of alphabet soup when it comes to understanding the more innovative and exotic financial instruments available today. The continuing evolution and creation of such financial instruments is due to the needs of companies to 1) raise capital while improving their financial statements, 2) improve their financial statements only, and/or 3) raise capital at a lower cost than that provided by more traditional financial tools [Pantalone and Welch, 1987].

What follows is a primer for accounting practitioners and those in academia whose daily activities do not ordinarily include the rapidly changing, expanding, and sometimes arcane world of financial instruments. A brief description of the more innovative, advanced or exotic types of financing tools is included to provide an introduction to the variations on mortgages, securities and interest rate tactics available to sophisticated financial managers and investors. The items discussed are not all-inclusive, but were chosen as a representative sampling of the contemporary creative developments in the financial arena.

The new financial instruments have caused some problems regarding accounting and reporting treatment: Are they debt, quasi-equity, or some hybrid? Many of the issues before the Emerging Issues Task Force (EITF) are concerned with the accounting and reporting recognition, measurement and disclosure aspects of such instruments. The remaining sections of this paper provide a brief introduction to the EITF, and a discussion of the more advanced or exotic financial instruments currently available to the adventurous company and investor.

Emerging Issues Task Force (EITF)

The Financial Accounting Standards Board (FASB) created the Emerging Issues Task Force (EITF) in 1984 to provide timely guidance on new issues not addressed by existing accounting standards and pronouncements. The EITF identifies these issues and reaches a consensus on how each issue should be handled, advising the FASB on any possible actions necessary. In this way, the number of FASB statements and technical bulletins are kept to a minimum, and practitioners have the EITF's guidance in a timely manner.

The EITF meets every six weeks to study specific issues of concern to practitioners, and, more rarely, to the SEC and other outside agencies. A consensus providing detailed accounting guidance on a specific issue is released when at least thirteen of the fifteen voting members agree on an accounting approach. At the end of 1988, the EITF had either resolved or were currently addressing 190 issues, of which 61 were concerned with new financial instruments and off-balance-sheet financing.

In addition to the EITF providing more immediate guidance in these two areas, the FASB began a long-term project on "Financial Instruments and Off-Balance-Sheet Financing" in May 1986. The scope is so large and the subject matter so detailed that it is expected to take at least four years to adequately address the aspects of financial instrument disclosures, recognition criteria, measurement issues, and hybrid debt-equity instruments. An Exposure Draft, "Disclosures about Financial Instruments" was issued in March 1988.

Financial Instruments

The more conventional financial instruments include but are not limited to debt with either fixed or floating interest, debt with detachable stock warrants, and convertible debt. Most practitioners and academics are familiar with these time-tested debt instruments, with much literature devoted to their accounting treatment, measurement, and disclosure.

Some of the more advanced instruments may be familiar from the pages of the Wall Street Journal, Barron's, and other publications. Others may be quite new. What follows is a short introduction to the perhaps less familiar of the financial instruments available in today's financial markets.

Collateralized Mortgage Obligations (CMOs) and CMO Residuals

CMOs were first introduced in June 1983 by the Federal Home Loan Mortgage Corporation (FHLMC). CMOs are debt securities, such as cash-flow or pay-through bonds, backed by a pool of mortgages or mortgage-backed securities issued by the Federal National Mortgage Association (FNMA - Fannie Maes), the Government National Mortgage Association (GNMA - Ginnie Maes), and the Federal Home Loan Mortgage Corporation (FHLMC - Freddie Macs). There are also private issuers, such as various financial institutions and construction firms.

Each CMO can be divided into classes of bonds, called tranches, each with a different average life and maturity. If a CMO has four tranches (A, B, C and Z), maturity and payoff would be sequential, with the class A bonds having the shortest term and providing the quickest return of principal. Tranches B and C would be considered medium- and long-term, respectively. Interest payments would be made on a current (monthly, quarterly, or semi-annually) basis to class A, B and C bondholders, while interest would accrue to class Z bondholders. Principal would be paid first to class A bondholders; when these are fully paid, principal would then be paid to class B, and finally class C bondholders. Only when tranches A, B, and C have been fully paid as to interest and principal will class Z bondholders receive payments for principal and accrued interest, usually at maturity. Tranche Z generally appeals only to tax-exempt investors, since tax must be paid on interest as it is earned, not when paid.

CMOs are usually AAA rated, and so are very safe with a minimal risk of default on interest and principal payments; they also offer some call protection against prepayments. CMOs are considered debt obligations of the issuer for tax purposes because of the Sears Trust rule. One aspect of this rule stipulates that the CMOs are not equity in the mortgages which act as their collateral. It is the collateral which gives rise to the cash flow to the bondholders. Taxation is "unclear due to the uncertainty of mortgage prepayments that affect yield on CMOs. The issuer's interest deduction depends on the CMOs uncertain yield." [Carl and Jurer, 1987] CMOs must be treated as corporate debt, and not the sale of assets, in order to avoid double taxation, where the interest paid to the bondholders is deducted for tax purposes by the issuer. In effect the Sears Trust rule imposes artificial tax constraints and over-collateralization, which are reinforced in FASB Technical Bulletin 85-2. GAAP requires that the CMO be treated as a liability of the issuer if it satisfies the tax law criteria for debt. The CMO cannot be treated as a trust because it has multiple classes, so many issuers are opting for Real Estate Mortgage Investment Conduit (REMIC) status (REMICs are discussed in a later section). Eventually, most CMOs will be replaced by REMICs in 1992.

After the tranches or classes of bondholders have been satisfied as to principal and interest, the residual interests share in the cash remaining in the mortgage pool. The CMO residuals are usually unrated as they are riskier than CMOs themselves. The increased risk arises because "the return on a residual interest is more dependent on prepayments on the underlying mortgages" [Kelley, 1988]. Prepayments will increase in an environment of dropping interest rates, causing less interest to be paid on the remaining balance, leading to a decrease in any residuals.

Stripped Mortgage Backed Securities (SMBS): Interest-Only (IOs) and Principal-Only (POs) Certificates

Partially stripped securities were introduced in July 1986 by FNMA (Fannie Mae), with fully stripped IO/PO SMBS available in February 1987. the cash flow is "stripped" from the mortgages into principal and interest components. Each cash flow can then be sold separately to different investors.

The IOs get all the "interest payments," but no principal, and are uncertain as to both the amount and the timing of cash receipts. The POs get all the principal payments, but none of the interest. POs are uncertain only about the timing of the cash receipts, since the principal amount is certain.

In an environment where the interest rates are dropping, POs will get an increased yield because more prepayments will occur. In the same environment, IOs will experience a lowered yield because these increased prepayments will lower the principal balance upon which the interest is computed [Kelly, 1988].

Synthetic (Derivative) Securities

A synthetic mortgage security is a hybrid formed by "combining the cashflows of a derivative mortgage security (a strip) with the cashflows of a standard mortgage pass-through" [Darivoff, 1987]. Such financial instruments are helpful in lessening the impact of volatile interest rates and unanticipated prepayments on expected yields.

Investors mix IOs and POs to manage portfolios in an environment of changing interest rates to obtain a certain yield without having to trade securities already in the portfolio. If interest rates rise, IOs will be added to the existing portfolio. Conversely, POs will be added if interest rates drop.

Real Estate Mortgage Investment Conduit (REMIC)

Introduced in the Tax Reform Act of 1986 (TRA '86), the REMIC is not a security, but a vehicle or "structure that determines how an issue of multiclass mortgage-backed securities will be taxed" [Altarescu and Pearl, 1986] while avoiding two levels of tax. REMICs should be the dominant vehicle for the issuance of multiple interest class mortgage securities beginning in 1992. If the securities meet the REMIC criteria, they can be treated as mortgage investments and not corporate debt, which is one of the drawbacks of CMOs. GAAP depends on the legal form of the REMIC security; it can be treated as debt (bonds) or as a sale (pass-through).

REMIC status can be chosen for any entity (partnership, trust, corporation) whose securities satisfy the following:

1. at least one security must have a class of "Regular Interest" holders, such as an interest in the pool of mortgages,
2. there must be one, and only one, class of "Residual Interest" owners, which is an interest not designated for regular interest holders, and
3. REMIC status is chosen in the first taxable year, or is in effect for all prior taxable years.

The tax rules for REMICs are clear, allow for uniform tax treatment, and are favorable to the investor. A REMIC can be "structured as a(n asset) sale, rather than a debt (so) it can be used as a qualifying real estate investment for savings institution tax purposes. CMO cannot" [Linnen, 1986]. Also, "TRA '86 provides that REMICs are not separate taxable entities, and are not subject to taxation. Instead, income is allocated to the holders of the REMIC interests under special rules in IRC 860A-860G [Kramer, 1988]. Regular interests are taxed like debt securities, with income recognized under the accrual method. Residual interests are treated as ordinary income or loss. IRC 860 C(c)(1) provides that REMIC distributions are tax-free, as long as they are less than the owner's adjusted basis in the residual interest. REMICs allow a choice of accounting treatment, depending on their structure either as a sale of an asset (via a grantor trust) with off-book accounting treatment, or as a debt instrument (via a CMO) with a liability on the books and no income associated with the sale.

Interest Rate Swaps

Interest rate swaps began in the early 1980s, and involve contractual agreements for the "exchange between two or more entities of the interest payment streams" of two instruments, but does not involve the swapping of principal [Rue, Tosh and Francis, 1988]. The swap of a fixed rate of interest for a variable rate is called the plain vanilla swap, and gained in popularity in 1981. A variable for variable rate swap, called a basis swap, soon followed. A basis swap uses variable rates based on different indices, such as swapping an interest payment streat based on the prime rate for one based on a foreign index, such as the London

CIBs

Interbank Offeror Rate (LIBOR). The third type of swap is the circus, or cross-currency, interest rate, swap. The circus swap combines an interest rate swap and a currency swap for principal, reaping the reduced interest expense afforded by the former while raising capital and increasing earnings per share through the currency swap.

The advantages of interest rate swaps include control over the interest rate risk by matching interest costs and revenues, active management of risk rates by letting companies "obtain lower financing costs through effectively changing the nature of their existing debt" and comparative advantage, to allow the exploitation of different characteristics of different markets [Rue, et al]. Swaps are also inexpensive to arrange, and provide flexibility in financing. The credit risk is small, limited only to the difference in the interest rates if there was a default, since there is no swap of principal in plain and basis swaps.

For accounting purposes, FAS 80 dictates that a "firm would recognize a change in the market value of an open futures contract as a gain or loss in the period of the change unless: the contract qualifies as a hedge of a present exposure, or the contract relates to a qualifying anticipated transaction" [Rue, et al].

Forward Swaps

A forward swap is an interest rate swap that begins on a future date, enabling a company to lock in favorable rates.

Swaptions

Swaptions, introduced in 1984 by Kleinwort Benson (United Kingdom), are options on interest rate swaps, or interest rate options. These allow a company to "lock into their borrowing cost for a period by buying an option to fix the interest rate on a borrowing linked to six month LIBOR ... but still have the advantage of cheaper funding if interest rates fall" [Cooper and Shegog, 1987]. The disadvantages are the costs involved in buying an option, and the need for a sophisticated tracking system to realize the benefits of a swaption.

Forward Currency Contracts

Forward currency contracts, also known as forward exchange transactions, are "agreements to purchase/sell fixed amounts of one foreign currency in exchange for another foreign currency" [Brooks and Bhave, 1981]. These are individually tailored agreements between two parties, without any specific settlement dates, quantities, etc., allowing greater flexibility for the participating parties.

Zero Coupon Bonds

Zero coupon bonds separate into interest coupons and principal for sale to separate investors. The principal is stripped from a regular bond (corporate, municipal or treasury) and sold without interest at a deep discount. Zero coupon bonds can be proprietary or government-backed, as the following list of past and present bonds indicates:

1. TIGRs (Treasury Investment Growth Receipts): Merrill Lynch, 1982.
2. CATS (Certificates of Accrual on Treasury Securities(): Salomon

Brothers, 1982.
3. LYONs (Liquid Yield Option Notes): Lehman Brothers (no longer on market).
4. STRIPS (Separate Trading of Registered Interest and Principal Securities): Department of the Treasury, 1985.
5. CIBs (Tax-exempt Compound Interest Bonds): Municipalities.
6. ABCS (Agency Backed Compound Securities): Kidder, Peabody (are secured by GNMA, FNMA and FHLMC securities).

The benefits of zero coupon bonds are ease of sale in the market with reinvestment if interest rates are volatile, a "locked-in rate of return ... no reinvesting of coupon payments, no callability factor (for STRIPS), (and) no quality questions: [Crim, 1987]. Disadvantages include early call provisions for some non-Treasury bonds, high broker fees, and the taxing of interest in the year earned, rather than when paid at the maturity of the coupon package. The advantage of a locked-in rate of return can be a disadvantage if the market environment changes. The tax aspects make zero coupon bonds attractive for financing IRAs, Keoghs, college funds, institutional fixed-income funding, or for low income tax bracket investors.

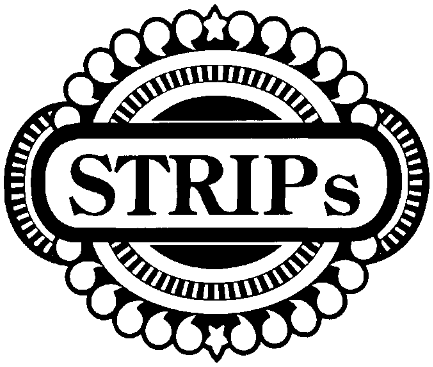
Most zero coupon bonds are sold in $1,000 units. For smaller investors, the emergence of zero coupon mutual funds allow investments as small as $100.

Adjustable Rate Preferred Stock (ARBs)

Introduced in May 1982 by Chase Bank and Chemical Bank, adjustable rate preferred stock is primary equity capital with the benefits of a debt security, including the tax advantages to investors. The benefits of issuing ARPs include the improvement of the capital ratio without the dilution of common stock; a senior claim on earnings, making dividends more reliable; and, qualification of 80% of the dividends for the dividends-received deduction for tax purposes to avoid double taxation. The main disadvantage is the existence of both a floor and ceiling on the rate at which dividends are paid.

Auction Rate Preferred Stock

Introduced in 1984 by Shearson Lehman (American Express), auction rate preferred stock is collateralized preferred stock, also



known as money market preferred (MMP), and is a variation on ARPs (see prior section). The name is derived from the process by which the "dividend is periodically adjusted by reference to a so-called "Dutch Auction' in which holders (and potential holders) of instruments bid to buy or sell the instruments among themselves" [Silversmith, 1987].

Auction rate preferred stock overcomes the disadvantage of ARPs in that there is no limit on the rate on which dividends are figured. Benefits include the protection of principal and the floating dividend which is reset every 49 days to match current market rates. This 49 day cycle is an approximation of the 46 day holding period required for tax deduction eligibility. Some disadvantages include the 49 day auction process, causing 49 day liquidity intervals and constant participation and monitoring, a high initial investment per share, and the uncertainty of the secondary market, which may become thin in reaction to changing market rates.

Some questions remain as to the nature of auction rate preferreds: are they primary capital (general consensus is yes), and are they qualified for tax reduction? Since the risk is so small, is it really risk for the purposes of qualifying for the 80% dividend-received deduction?

Similar to zero coupon bonds, auction rate preferreds are being incorporated into mutual funds for ease of management, instant liquidity, and smaller initial investment.

Securitization of Assets (Other Than Mortgages)

The securitization of assets involves the sale to outside investors of high quality financial assets such as credit card receivables, automobile loans, and lease payments in a loan portfolio. These assets become liquid securities paying principal and interest to the investors as the loans and receivables are repaid. A group of loans and/or receivables are put into a grantor trust, which then issues certificates which can be purchased by investors. In 1985, collateralized lease equipment obligations (CLEOs) were introduced by Sperry Leasing Corporation and certificates of automobile receivables (CARs) by General Motors Acceptance Corporation (GMAC) and various banks. In 1986, certificates of amortizing revolving debt (CARDs) were issued by Salomon Brothers through Bank One, and Marine Midland Bank.

The benefits of asset securitization include "lower financing costs, particularly for issuers with high quality receivables; eliminating ongoing funding uncertainty of owning receivables by directly funding these receivables; shrinking the balance sheet through off-balance sheet accounting treatments, if the security is structured as a sale; and presenting new business opportunities for companies that can originate high quality receivables, sell them in securities, and retain upfront fee and ongoing servicing income" [Johnson, 1986]. The primary cost of securitization is that most often only the higher quality assets are securitized and removed from the balance sheet. The company or bank is then left with lesser quality, riskier assets on their financial statements.

Asset securitization can be carried out as either a sale structure or a debt structure. The sale structure "results is an asset-backed pass-through certificate issued by a grantor trust. Assets are sold outright, and the seller has no obligation regarding repayment" [Hull and Annand, 1987]. Certificates of automobile receivables (CARs) are structured as sales. The debt structure, as represented by certificates of amortizing revolving debt (CARDs), "involves notes that are collateralized debt obligations of the issuing bank. The bank treats the debt transaction as secured financing ... requir(ing) creation of a finance subsidiary of the bank. The subsidiary purchases a pool of assets from its patent bank and issues fixed notes secured by the assets".

Perpetual Debt

In 1984, Citicorp was the first United States bank to issue perpetual debt in the Eurobond market. Perpetual floating rate notes (FRNs) are "notes with a floating rate reset at certain periods but without any final maturity date" [Campbell, 1987]. There has been confusion as to the nature of perpetual debt; FRNs are quasi-equity, and are treated by the issuers as primary capital. Investors in FRNs, however, must consider them to be subordinated debt, because "holders effectively have an equity instrument which pays them after all creditors, and even depositors, in the event of bankruptcy."

The main problem experienced by perpetual debt instrument issuers and holders is that, as margins narrow, investors are not getting paid enough to compensate for the subordinated debt/quasi-equity risk, so market liquidity disappears. The FRNs are then very difficult to trade.

Defeasance of Debt

Prior to 1982, when Exxon was the first corporation to successfully carry out an in-substance defeasance of debt, only state and local governments were doing so. Defeasance involves removing the debt from the company books while investing in risk-free government securities. These securities and/or cash are then placed in an irrevocable trust from which the interest and eventually the principal of the original debt will be paid. SFAS #76 provides the criteria for the extinguishment of debt with a specified maturity and fixed payment schedule and its removal from the financial reports. This defeasance gives rise to a tax-deferred gain for accounting purposes, but has no tax effects because the debt has not been actually retired.

Companies choose to defease debt for better debt management during a period when interest rates are changing such that the rates are higher than the original debt's coupon yield; as a defensive mechanism to use up cash which might invite takeover attempts; and, to improve the balance sheet and financial ratios. The interest on the defeased debt is deductible for tax purposes but has no effect on the financial statements, and therefore no effect on reported profits. Defeasance leads to an immediate improvement of reported earnings, lower taxes, lower interest expense, lower debt/equity ratios, higher earnings per share and higher return on assets.

Certain types of debt cannot be defeased, including debt with floating interest rates, debt payable upon demand, convertible debentures, convertible debt, leveraged lease financing, and newly issued debt [McDonald and Sutton, 1984]. The latter is an attempt at instant defeasance, where a company borrows and defeases instantaneously, usually borrowing in the European market at lower rates, defeasing the debt and investing in United States government securities at a higher rate. This gives rise to an immediate gain, and is prohibited by SFAS #76, which applies only to existing, and not newly issued, debt.

Questions have arisen about the propriety of defeasing other financial instruments, such as redeemable preferred stock, which is currently an equity transaction and therefore cannot be defeased; callable debt, which can be defeased after all the variable aspects are dealt with; and capital leases, which can be defeased if using a fixed payment schedule and not contingent rentals.

Redeemable Equity

An early use of redeemable equity was by Great Britain's Hawley group and Credit Suisse First Boston in 1986. Redeemable equity is preferred stock with mandatory redemption features; since it is equity, it therefore improves the debt/equity ratio, which convertible bonds do not. This instrument is used to raise cash quickly, but it is subject to a debt versus equity debate. Currently, the issuance of redeemable preferred stock is treated as a capital transaction with no attendant gains or losses.

Conclusion

The foregoing discussion of financial instruments was not meant to be all-inclusive or encyclopedic. The purpose was to provide those practitioners and academics in accounting who do not ordinarily deal with such items with a brief introduction to the rapidly changing, expanding and sometimes confusing world of financial instruments.

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Positioning Women as Full Partners

Lillian C. Parrish, Ph.D., CPA

Working women are locked in a struggle for power over their own lives according to Judy Mann, columnist for The Washington Post and keynote speaker at the opening session of the Joint Annual Meeting in Washington, D.C., in October. Working women are pitted against traditional women, and as a result, working women are trying to be superwomen. Mann says working women only have themselves to blame if they don't participate in the movement to restructure society to position women as full partners with men.

Because of the superwoman syndrome, Mann says time is the one thing working women have not had. She says working women have been exhausted and invisible. Mann challenges working women not to continue running in place until they drop from exhaustion.

Mann describes herself as a person who works with people and who is intimidated by people who work with numbers. Yet she says women in the media and women accountants share common concerns. Empowering women in politics, business, and at home has been the unifying theme of Mann's work for the past 12-15 years, and she urges all women to continue to struggle together to become full partners in society in America.

Look at the past 25 years, says Mann, to see profound changes in society in the United States and other industrialized nations. These changes have not been limited to the women's movement. Mann says in the U.S. we are in the process of changing the entire society. She says there is a restructuring of a society controlled by white men to one equalitarian society, a society where women and blacks are full partners. Mann says women are currently associate partners and need to become full partners.

Mann maintains that sexism pervades every facet of our society. She says her areas of activity, the media, is no exception. In her opinion the media's role is important because it helps set the agenda in a free society. Mann says, "Information is powerful, and without it we cannot affect the political changes we need." But, she adds, "Media is too male and too pale!" There are no columns about contemporary women's needs. She asks, "How many challenge? How many write letters to editors?"

Mann admits mainstream media is not interested in showcasing the legislation needed to enable working women to do a better job of balancing their families and their careers. This legislation is needed, insists Mann, to provide new solutions to new problems. She says legislation is needed to provide choices to women in the care of infants, school children and elderly parents. Mann calls the defeat of one such law, the Family and Medical Leave Act, another nail in the coffin of productivity. (Germany and Japan, both leading the U.S. in productivity, have paid leave.)

The debate about whether women should work is over according to Mann. She cites the following statistics: half of all mothers work, half of all professionals are women, and 30% of the businesses operated in 1987 were owned by women. Mann credits the acceptance of women in the workplace to the previous generation of mothers who flexed their muscles and took on a hostile workplace. She says working women now compose a critical mass and do not have to accept the old model of a male-dominated hierarchy.

Touching on the difference in the socialization of men and women, Mann says only recently has the female style of communication been validated. She says women want to understand their male counterparts and make peace. Furthermore, women want to secure the family support system necessary to be full partners in society.

Mann maintains that the most pressing economic concern is the salary gap between men and women workers. As an example, she uses salary structures in 1987 when, for men and women performing identical jobs, women received only two-thirds of the salary paid to men. This was equivalent to women receiving nothing from 9/1 to 12/31 while men were paid.

In Mann's opinion, women have not done a good job of educating men about how they would be served if women were paid what they should be. The entire salary structure is being pulled down by the two-tier system. Not only are women paid less under a two-tier system, but men's salaries are depressed also. According to Mann, since income peaked in 1973, it has been working women who have kept income from dropping. Mann urges women to bring men over to their side and to persuade them that it is in their interest to make women full partners in their society. She says women need men lobbying with them.

Since women pay a high personal price for a career, Mann says this means they will not settle for one that is not satisfying. She supports this argument with the results of a study of 110 professional women who had left their jobs: 73% left to go to another job while only 7% left to go home. "Help them grow or watch them go," are the words of advice Mann gives to employers of professional women.

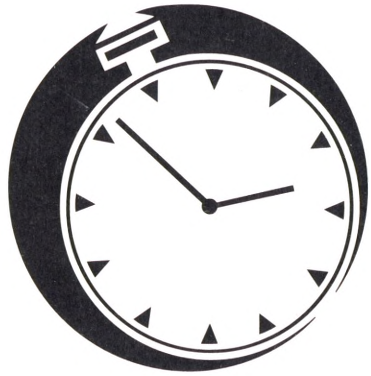
The single greatest influence on the political scene has been the entry of women into the work force. Mann says women can and should stamp their own values and priorities on the way America operates. In the past 25 years, women have changed their attitudes, their worth, what they want to do. When they vote, says Mann, they show what they believe is important and they vote differently from men.

According to Mann, the climate currently is more favorable for women in public office than anytime since Watergate. Yet, women hold only 6% of the seats in Congress and only 14% of the seats in state legislatures. She feels the absence of women in the Souter hearing was particularly significant since women have overwhelmingly voted to uphold women's abortion rights.

Mann urges women to be active and to be visible. Women need to challenge the status quo. Women need to write letters to editors. Women need to talk to Republicans and Democrats about gender gap. Women need to vote their self interests. Women only have themselves to blame if they don't seize these opportunities to position themselves as full partners with men.

Roundtable panel discusses issues facing women in the accounting profession during the next decade in the Saturday morning session at JAM.

Pictured from left to right: Joyce Simon, AWSCPA President Elect; Karen Mersen, Catalyst Panel Moderator; Diane Fuller, KPMG Peat Marwick; Kathy Wkaterski, Shinners, Hucovski and Company.



Pictured from left to right: Kathleen Kenny, Coopers & Lybrand; Steve Goldstein, Time Life Books; Shirley Cheramy, Price Waterhouse; Sherry Mosley, Corning, Inc., Ann Lang, Arthur Andersen; and Terese Collins, Deloitte and Touche.

Cash Recovery Rates and Profitability Analysis

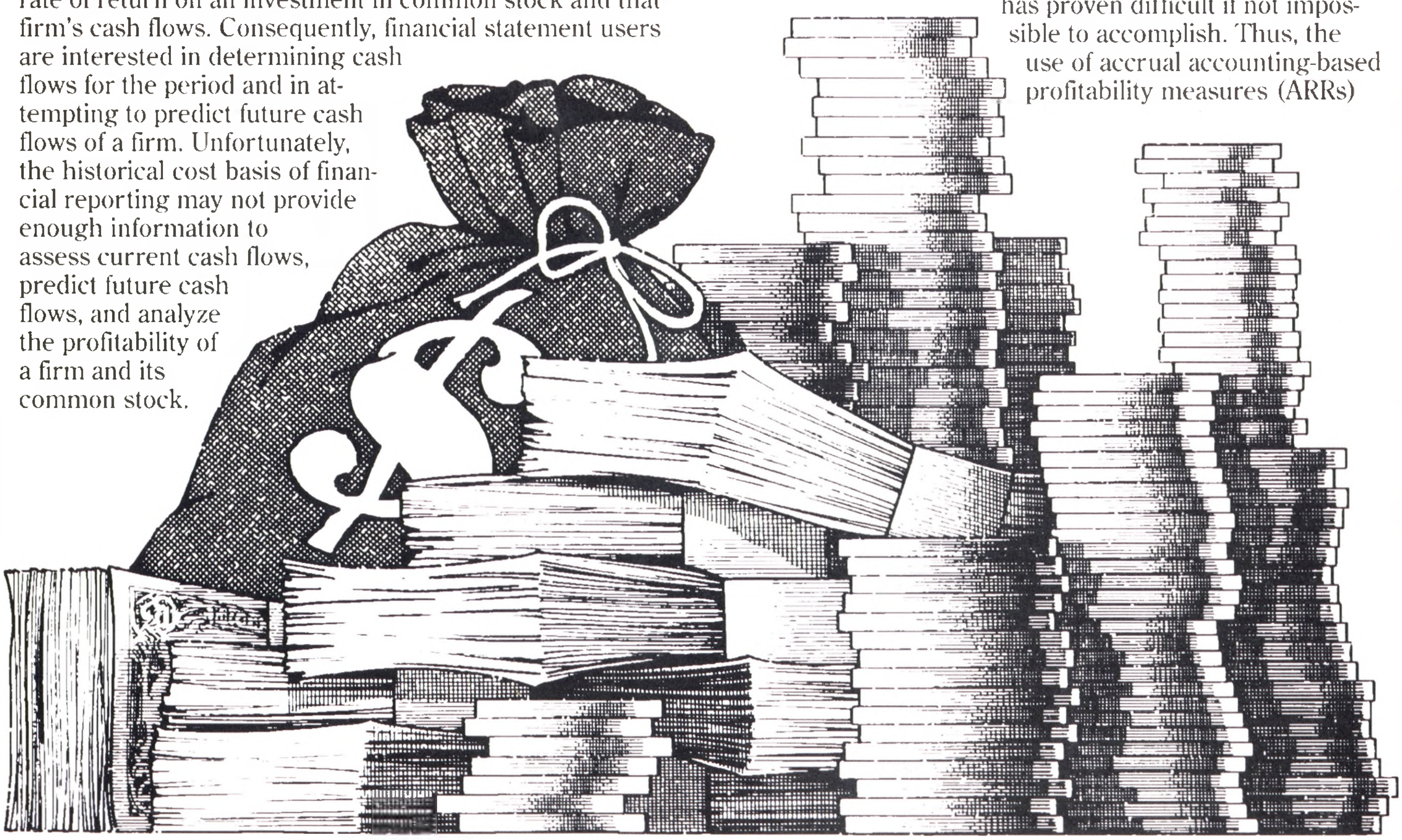
By Ara G. Volkan and Joseph C. Rue

Recent attempts of accounting policy makers to develop a conceptual framework for external reporting have emphasized investors' needs to evaluate firms' cash flow generating potential. The FASB statement on objectives stresses that financial reporting should provide information to help investors and creditors in assessing the amounts, timing, and uncertainty of cash flows. In addition, the FASB has argued that the market price of a common stock incorporates the market estimate of the discounted cash flows from the firm to its investors. Since these distributions are dependent upon the cash generation capability of the firm, the market must assess the amounts, the timing, and the uncertainty of future cash flows. Thus, there is a direct link between an investor's rate of return on an investment in common stock and that firm's cash flows. Consequently, financial statement users are interested in determining cash flows for the period and in attempting to predict future cash flows of a firm. Unfortunately, the historical cost basis of financial reporting may not provide enough information to assess current cash flows, predict future cash flows, and analyze the profitability of a firm and its common stock.

Evaluating Firm Profitability

At present the accounting rate of return (ARR) is the most commonly used measure in evaluation of a firm's profitability. The ARR, which is the ratio of net income to net assets, is used primarily because it is easy to compute and understand. However, the internal rate of return (IRR) is a better measure of profitability than the ARR.

The IRR can be defined as the "true" interest yield by an investment project over its useful lie. It is the cash rate at which the discounted present value of future cash flows is equal to the current investment. A number of studies have attempted to estimate the IRRs of companies from published financial statements. In spite of these efforts, the computation of firm-specific IRRs by external parties has proven difficult if not impossible to accomplish. Thus, the use of accrual accounting-based profitability measures (ARRs)



were justified, since cash flow based surrogates for the IRR and other alternative profitability measures were not readily available.

Ijiri introduced the cash recovery rates (CRRs) as possible surrogates for IRRs in 1978. He found that if certain conditions related to the average life of fixed assets, the size of the firm, and the stability of CRRs were met, the CRRs could be used to approximate the IRRs. Using a cash flow variable in the evaluation of managerial performance is superior to an accrual approach, since it may be assumed that management invests the firm's resources based on discounted cash flow (net present value) analyses. Thus, the evaluation of managerial or firm performance should logically be based on cash flows rather than earnings.

In this paper we first discuss the CRR concept developed by Ijiri. We then the address the usefulness of CRRs in the analysis of a firm's profitability by: (a) testing the stability of the CRRs under the conditions suggested by Ijiri, and (b) discussing how these empirical results show that the CRR model is generally valid when a firm displays certain financial characteristics.

Usefulness of Cash Flow and Recovery Rates

The ideal measure of the value of a firm can be thought of as the present value of the cash inflows generated by the firm's operations. Research in accounting, economics and finance has consistently shown that the efficient functioning of capital markets depends upon reliable predictions of net cash flows and the discount rates specific to an individual firm or group of firms.

The management of a firm will have access to various information in making investment decisions. Internal investment decisions are generally based upon the ability of a project to generate sufficient cash flows to provide at least a minimum rate of return. Given a choice between alternative projects with relatively equal levels of risk, management will select those projects with the highest return above the minimum or hurdle rate. Investors and creditors, who view the firm as the aggregate of its projects, need similar information on internal rates of return and cash flows in order to value the firm.

However, current financial reporting rules require that audited financial statements be prepared using accruals and historical cost information, thus giving prominence to income measures. The resulting financial information is therefore influenced by choices of accounting methods (e.g., depreciation and inventory valuation methods) and may not be as useful in predicting future cash flows.

Ijiri asserted that the investors needed to have information on the cash recovered (generated) by all of the firm's projects in order to predict the firm specific IRR. The knowledge of cash flow patterns of the firm's individual projects was not necessary. Cash recoveries were defined as cash from operations, plus the proceeds from disposal of long term assets, plus interest expense (net of tax). This cash recovery was then divided by gross assets which were defined as average total assets plus accumulated depreciation for the period. Thus,

Cash Recovery Rate = Cash Recoveries/Average Gross Assets.

The recovery rate represents the reciprocal of the payback period, and allows one to measure the return on the firm's portfolio of investments. Moreover, the cash recovery rate can easily be computed from published financial statements.

The Stability of CRRs

Previous studies have shown that most large and mature firms included in their analyses displayed stable CRRs over time. The existence of some degree of stability may be desirable, because it may be assumed that managers of successful firms try to achieve at least the overall return rate originally used by them as a bench mark for investment decisions. Thus, individuals computing CRRs may assume that at the very least, the stability assumption holds for large and mature firms. Indeed, Ijiri implicitly assumed that large firms (various asset size thresholds can be used to define "large") with average useful asset lives of 15 years or longer and payback periods of 7 years or less (a CRR of 14 percent or more) would have relatively stable CRRs.

A stable CRR implies that a firm or a division of a firm can be viewed as one investment without regard to the cash flow profiles and useful lives of individual projects comprising it. Then, the CRR concept can operate at the aggregate level rather than at the individual project level. Over the average useful life of the firm's

'Testing the Stability of CRRs Under the Conditions Specified in Ijiri's Model

We examine the stability of CRRs in order to: (a) generalize Ijiri's arguments by including a large number of companies in the analysis; (b) observe whether the CRRs are stable with regard to size; and (c) relate the project lives and CRRs of firms to the stability of CRRs. The objectives of this analysis is to determine: a) the conditions under which an investor can assume safely that the CRR is equal to the IRR, and b) when caution must be exercise in equating the CRR to a firm's profitability.

First we replicate Ijiri's work for the 1972-1978 period for 20 firms. Using financial statement information obtained from COMPUSTAT tapes, we have achieved similar results. This exercise indicates that CRR can be defined in terms of COMPUSTAT items and computed by users of financial statements, especially by financial analysts.

Next we observed whether companies achieved a stable CRR over time. First, for the period of 1974-1987, we computed the CRRs of all non-regulated companies that reported data for each of the fourteen years in the COMPUSTAT tapes. There were 1,090 such companies. We then computed the average (mean) and the standard deviation of the CRRs for each firm.

If management achieves a relatively stable CRR, the differences between individual CRR observations and their average (mean) would be small. We used a 95 percent confidence level in testing this hypothesis.

Standardizing the CRRs, we computed that a firm having a small standard deviation (0.51 percent) will have all its CRRs within one percentage point above or below its average CRR. For a two percentage point difference, the standard deviation must be at most 1.02 percent and 1.53 percent for a three percentage point difference. Thus, a firm with a 12 percent average CRR and a standard deviation of 1.00 percent will have all of its CRR observations in the 10-14 percent range.

Finally, we tried to determine whether or not the firms with highly stable CRRs had common characteristics. In order to achieve this objective we classified the 1,090 firms by their standard deviations into two categories: stable (below or equal to 2.04 percent) and unstable (above 2.04 percent). We then observed their industry classification codes (SICs), total assets,a dn project lives since Ijiri indicated a possible relationship between the stability of CRRs and large and mature firms. Industry membership was observed to see whether CRRs were uniformly stable in certain industries and not in others.

assets, individual project cash flows and their fluctuations are averaged over all projects.

When CRRs are stable, it is possible to assume that increases (growth) in investments, whether in real or nominal terms, are managed along with growth in cash recoveries so as to maintain or to increase the CRR. Mathematically, it can be shown that under such conditions one can equate the CRR to a firm's profitability, that is, CRR = IRR.

In the final analysis, the external validity of the assumptions of the CRR model can be observed empirically only. Thus, empirical analyses could address the following general questions: (a) Are cash recovery rates stable? and (b) Do these conditions universally exist in large and mature firms, as it is assumed by others? If these questions can be answered in the affirmative, IRRs (i.e., profitability) of such firms can be estimated. The test methodology is discussed in footnote 1.

Results

The test for stability of the CRRs produced 248 firms that had standard deviations of 2.04 percent or less. An examination of the stable group yielded the following results:

1. The 248 companies were scattered among all industries and only five SICs had 5 or more firms classified in them (grocery stores, department stores, drugs, chemicals, and computers).
2. 197 of the total 248 firms had both average project lives greater than 15 years and asset size greater than $100 million.
3. Only 6 of the remaining 51 firms had both average project lives less than 15 years and asset size less than $100 million.
4. The average CRR of the entire sample was 14.1 percent, with most firms showing above average CRRs.

An examination of the unstable group (842 firms) showed the following results:

1. There was no pattern of industry membership.
2. 366 firms out of the total 842 reported either average project lives of 15 years or more or asset sizes of more than $100 million. Firms with unstable CRRs that had both 15 years or more average project lives and $100 million or more asset size numbered 73 out of 366.
3. The remaining 476 firms showed both asset sizes of less than $100 million and average project lives of shorter than 15 years.
4. The average CRR of this sample was 10.73 percent with a range of 3.10 to 22.37 percent.

The results reveal an unmistakable pattern of conformity with model assumptions. Firms with assets over $100 million, average project lives of 15 years or more, and CRRs of 14 percent or more, exhibit stable CRRs most of the time (197 stable versus 73 unstable), while firms with the opposite characteristics generally exhibit unstable CRRs (6 stable versus 476 unstable). Finally, firms lacking one or more of these characteristics generally show unstable CRRs (45 stable versus 293 unstable). Thus, the accurate prediction of instability is more probable when some or all of the model assumptions are lacking than the accurate prediction of stability when all of these assumptions are present.

Concluding Comments

For the firms that exhibit stable CRRs and are large and mature, investors can use the CRR as the firm specific discount rate and profitability measure (i.e., IRR). However, for firms that exhibit various degrees of instability in their CRRs, caution must be exercises when CRR is used to estimate the IRR. In such instances, a determination of a number of CRR observations may be necessary coupled with simple or complicated forecasting approaches. Even then, the availability of a profitability analysis measure that is based on cash flows rather than accounting constructs must be comforting to users of financial statements. We believe investors will find that CRRs are more useful in evaluating firms' cash flows and profitability than ARRs.

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Elise Jancura, Editor
Cleveland State University

Microcomputers in Operating Departments: Controlling the Risks

By William Paxton, DBA, CPA

Control procedures such as documentation, program and data entry validation, and backup procedures followed by MIS, EDP and accounting departments provide a high degree of reliability for data originating from these sources. The proliferation of microcomputers (PC's) outside traditional data processing departments has resulted in operating managers using data for economically important decisions that have not been subject to such controls and, therefore, may be of questionable quality.

A manager's decisions will be no better than the data on which they are based. "Managers find the personal computer to be a strong yet flexible aid in analyzing complex marketing, financial and manufacturing data ... however, if incorrectly used, it could cost more money than it saves" [Merino, 1983]. Managers have come to rely on the quality of EDP output to the point that reports printed by computers are generally assumed to be accurate. This trust may be misplaced in the case of the output of PC's located outside the control of data processing and accounting departments.

Examples of spreadsheet disasters are not hard to find, and some have been widely publicized in the business press [Kseniak, 1984] [PC Week, 1986] [Howitt, 1985]. A few examples are presented below to illustrate the possible damage when simple checks and controls are omitted.

1. Executives from a Dallas-based oil and gas company were fired because errors in a spreadsheet cost the company several million dollars during a major acquisition.
2. An inventory manager used outdated data and ordered 30,000 parts at $4 each when current requirements were for only 1,500 parts.
3. A division of a large manufacturing firm had its payroll on a spreadsheet that had worked well for nearly a year. Minor modifications were made and the spreadsheet was only partially checked because of its history of reliable operation. A few months later it was discovered that the revised spreadsheet had given employees an extra nickle an hour raise above what they were entitled to, costing the firm over $10,000.
4. A small company used Lotus spreadsheets for its accounting system. It had to go back to a manual system when the only person who knew how to run the package quit. The company nearly went out of business while it was setting up a replacement manual system.
5. A firm had a critical spreadsheet application that failed after some needed modifications were made. The person who had created the spreadsheet had left the firm and there was little documentation of the program. The firm had to engage a consultant to get the application running again. The cost was high and urgent work was delayed.
6. A firm had its mailing list on a spreadsheet. Its vulnera-

bility was exposed when it tried to do a mailing while the person who normally ran the application was on vacation. They couldn't even find the template disk, let alone run the program.

Each of these examples presents errors which may be more costly to firms than intentional misuse of microcomputers.

Extent of the Problem

Published estimates that 30% or more of spreadsheets have errors [Creeth, 1985] [Greenberg, 1986] [Howitt, 1985] indicate that these are not isolated instances. It is obvious from the cost of the errors that this is a problem that should not be ignored. Good control procedures are needed to bring critical PC output to the point where it deserves the trust placed in traditional computer generated data.

It would seem that the extent of errors in PC generated output and the potential damage they can cause would motivate firms to act decisively to control these risks. This has not yet happened. Over seventy percent of the respondents in a recent survey of large publicly held firms indicated they had no controls over the development and use of microcomputer-based programs. Less than four percent indicated microcomputer applications were reviewed by an internal audit group prior to use. The other controls mentioned were essentially controls on the cost of developing an application, not quality control [Powell and Strickland, 1989].

> *It would seem that the extent of errors in PC generated output and the potential damage they can cause would motivate firms to act decisively to control these risks. This has not yet happened.*

Every spreadsheet or data base program (application) doesn't warrant submission to a full set of formal procedures before its use. Control procedures should be limited to applications where there is a favorable cost/benefit relationship. These would frequently include programs that affect recording of assets, ordering, initiation of payments, or that generate data whose uses may not be fully known. Programs whose output will be used frequently or whose output affects major decisions are also likely to satisfy cost/benefit requirements.

Adaptations of verification, documentation and backup techniques well known to data processing professionals would prevent most PC disasters just as they have prevented most of the potential disasters in conventional computing. These techniques generally are not applied to PC applications outside the accounting and data processing departments because they are not known to most persons whose expertise lies in other functional areas such as production or marketing. There also is a natural tendency for people to look toward the next task rather than check and document their work. Therefore, there is a need to establish standards and control procedures for critical PC applications.

The next section presents a documentation based quality control program to help reduce the risks associated with using data from microcomputers. The third section discusses the three ways managers are vulnerable when relying on microcomputer generated data and shows how the quality control program protects against these areas of vulnerability. Finally, the control process and its advantages are summarized.

Spreadsheet applications are generally used for illustration purposes throughout this paper, but similar considerations apply to other types of PC applications such as data base management and financial planning packages.

II. Control Procedures for Critical PC Applications

The control procedures outlined in this paper should be applied to those programs that can have a material effect on the economic performance or financial reporting of the firm. Just as purchasing departments implement different procedures depending on the nature, frequency and size of purchases, QCP administrators will adopt different procedures for spreadsheets and other programs depending on factors such as the frequency of use and magnitude of the impact an error can have on the firm. The set of procedures appropriate to individual firms can be developed internally or by consultants such as CPA's. The procedures should be reviewed and updated periodically.

The Accountant's Role in the QCP

Although PC based applications are a significant and growing part of corporations' information resources, they are often outside the formal information system of the firm. It is necessary to bring the most critical of these programs into the formal information system network of the firm. Otherwise, internal control is compromised and there is no way to assure the quality of the programs being used to support critical decisions.

> *AIS should establish criteria determining which programs are to be subject to the control procedure.*

Accountants are familiar with information requirements of businesses, microcomputer programs, internal control, and testing of computerized applications. This makes the accounting information systems (AIS) function a natural candidate to administer the QCP.

AIS should establish criteria determining which programs are to be subject to the control procedure. Firm wise standards should be established for program validation, documentation and control procedures. AIS should evaluate validation tests and documentation submitted for critical programs, maintain backup copies of approved programs and related documentation, and issue a directory of tested applications with their identification codes.

The internal audit department should include monitoring compliance with policy as part of its normal evaluation of internal control. Including evaluation of the micro-computer internal control process in the audit program will send a signal to operating departments indicating the importance of the process to top management and the firm.

Environmental Constraints

Control procedures must take into consideration environmental factors surrounding the use of PC's. Factors driving the increased use of PC's include:

- the ability to get programs up more rapidly than by going through the EDP department
- flexibility of PC software
- ability to modify programs quickly and easily
- costs that are lower than charges from an EDP department. A control program that significantly reduces these advantages is likely to be circumvented.

The QCP minimizes conflict with users by limiting the program to critical applications. In these applications the QCP operates primarily by requiring documentation that will be readily available if good program development procedures are being followed. The incentive for managers to insist on qualified programs is provided by holding them responsible for the effects of errors attributable to their use of non-qualified data.

Two points need to be noted here. First, the QCP is not directed at fraud. There are techniques to deal with such problems, but they are beyond the scope of this paper. Second, the QCP is not intended to prevent managers from using data produced by non-approved programs. The QCP allows managers to identify data as coming from a qualified program or not. They can then adjust their decision process to take the appropriate risk into consideration.

The QCP from the perspective of the data user

Data users are provided with a list of qualified programs and their identification codes. Each qualified program includes its code number as part of its output. The user merely needs to check the code, if any, on printouts he/she intends to use against the public listing of program identification codes. If the codes match, the user knows that the program generating the data has met QCP standards.

Elements of the QCP

A typical QCP will include program validation, evaluation of program, operator and data user documentation and program design criteria. The QCP administrator will maintain copies of program disks, program validation tests, and program, operator and user documentation. He/she will also issue identification codes to qualifying programs and distribute the identification codes of qualifying programs to potential users.

Program Documentation

Program documentation will generally involve the following elements:

- Definition of variables used in the program
- an overview of program operation including major assumptions and limitations
- an explanation of the operation of each block of program code where a block could be a single complicated macro
- a list of required input data and the source of these inputs
- a description of the program's output.

Program documentation is a key element in implementing control for erroneous data. Individual macros should be thoroughly described as to both function and detailed operation. Programs that are not well documented are very difficult to test and change even if the original author is still available to the firm, and next to impossible to deal with if he/she is not available.

It may be more costly to debug or update a poorly documented program than to generate a new program from scratch. Program maintenance over the life of a program can amount to several times the cost of writing the original program. Good documentation and program design can help cut these costs substantially.

Operator Documentation

Typical operator documentation would include:

- name of the program or application
- name of the person to be contacted in case of problems
- location of program disks
- date and identification code of latest revision
- description of data inputs required for the program and instructions for obtaining the input data
- instructions for loading and running the program
- distribution instructions including a distribution list and the method(s) of distribution
- frequency of reporting.

Operator documentation internal to the program would include prompts, other instructions displayed on the screen and other explanatory information displayed on the screen during program operation.

The objective of operator documentation is to allow a person unfamiliar with the program to successfully run the application. Conformity of operator documentation to this requirement can be tested by giving the documentation to a person unfamiliar with the program and asking him/her to run the program. An identification code should only be issued to programs whose documentation pass the test.

Data User Documentation

User documentation includes both documentation in the program output and stand alone documentation. The formal documentation must include, at a minimum, a clear statement of the purpose of the program, the assumptions made, limitations of the program, the inputs and outputs of the program, and sample output. The sample output is preferably from a validation test run using historical data that the user can check for consistency with experience. The programmer and user must agree on these matters and both must sign off before the documentation is accepted for controlled programs.

Documentation in the program output should include identification of the version of the program, its date, the program identification code, the date and source of critical input data, operator identification, and a brief description of the output. Warning messages should appear if any input or output is outside predetermined limits.

Specific situations may require expansion of the user documentation described in a general fashion above. No mechanical procedure will catch all problems. The user will always have to use judgment to determine whether the data seem reasonable in the light of experience and current circumstances. It is the user's responsibility to investigate further if something appears to be abnormal. The procedures outlined above will, however, reduce the risk of undetected errors.

Program Controls

Program controls include program elements to avoid or signal possible errors. Some common program controls include:

- use of checksums, footing and crossfooting, and automatic comparison of input and output data with pre-set limits
- protecting all cells of a spreadsheet except those that are to accept data
- use of windows or data entry tables
- use of compiled programs including spreadsheets and data bases
- use of macros to cause automatic recalculation when the operator issues a print command.

This listing of QCP elements is not exhaustive. QCP administrators will add, change and delete elements to create a QCP appropriate to their firm's specific needs. It does, however, provide an indication of the nature of a QCP.

Managerial Vulnerability and the QCP

Managers who rely on data from others are vulnerable in three ways: (1) the data they need may not be available when they need it, (2) the data may be available but erroneous, or the (3) data may be valid and available, but the manager may not understand the data as presented. Common causes of each problem will be presented below. A discussion of how the QCP addresses each problem is presented with the discussion of the problem.

Unavailable Data

Lack of data availability can be caused by hardware problems, software problems and operator problems. Hardware problems are the simplest to solve. Other compatible PC's at the same location can provide short-term backup. Service contracts and the relatively low cost of replacement equipment provide viable solutions for hardware failures.

A damaged disk or missing disk can prevent production of data needed by managers. The archival copy of the program maintained by the QCP administrator can be used to make additional copies if the operating department's disks are lost or damaged.

- Operator Problems

Lack of an operator can effectively prevent production of necessary data. Two techniques can be used to counter this problem: operator backup and operator documentation. Training more than one operator to run a program is generally effective, especially if the backup operator(s) periodically make production runs to keep their level of competence high. Maintaining backup operators is not always practical and does not take care of the situation in which the backup operator is also unavailable. Maintaining backup operators should be strongly encouraged, but cannot be the primary basis of control.

Operator documentation can be used as both a method of control and a means of decreasing dependence on specific operators for critical data. Persons with the ability to create spreadsheet templates, data base programs, etc., are too valuable to use for program operation, which should be basically a data entry operation. The programs should, therefore, be designed for simplicity of operation.

Operator documentation and the operating characteristics of the program should allow a person unfamiliar with the program to assemble the inputs required, generate the required report, and distribute it to the proper persons by following the documentation. As discussed earlier, a QCP identification code is only issued to programs with documentation satisfying this requirement.

Erroneous Data

Erroneous data from PC programs is both common and serious. Some of the more basic causes of erroneous output include program errors, data entry errors and use of the wrong version of a program. Errors will be made in writing a program of any significant length or complexity. Inadequate validation testing can allow these errors to remain in the final version of a program.

The QCP policy requires validation tests for critical applications, with the test results to be submitted as a condition for issuing an identification code. This will help in two ways. It will make those writing program more familiar with validation testing and it will make the programs they write much more reliable.

the particular tests should be selected by knowledgeable personnel to be appropriate for both the firm and the type of application under consideration. The nature and scale of testing must have a favorable cost/benefit ration and at times may be substantially less extensive than testing of mainframe programs.

In some cases, PC validation testing might be limited to checking to see that row and column totals match, testing with artificial data such as all ones or 100's that make errors easy to spot and testing with historic data for which the "right" answer is already known. Commercial programs designed to audit specific software packages for specific common problems such as logic errors and circular references are economical and can be very useful. Other applications might require much more extensive testing.

The application developer may need to consult with the QCP administrator, internal audit or EDP personnel, or the firm's CPA's to determine the appropriate testing procedure for especially critical or difficult applications.

- Protecting Against Data Errors

Erroneous output resulting from bad input can occur because of data entry operator error, errors in the source data, and use of the wrong data set for input. These errors can be significant, and the simple techniques that are practical to use in many applications will help, but will not catch all errors.

Use of more than one data entry operator and comparing their input will catch many mechanical errors. This procedure is not always practical, however. Checksums and footing and crossfooting are useful and can be implemented without undue difficulty. Comparison of input data with pre-set limits will catch some data source and data entry errors. Program input should include the source and date of input data. Including this information in the program's output allows both the operator and the user to verify that the correct data source is being used.

Protecting all cells in a spreadsheet except those that are to accept data input can help avoid unintentional modification of the program which could give erroneous output. Use of data entry tables minimizes the input strokes needed to enter data into the program as well as the likelihood of input errors or omitted input. Compiling spread sheets, data base programs and other programs can avoid some errors that result from operator interaction with the program.

A common spreadsheet error is for operators to turn off the automatic recomputation feature of spreadsheets while entering data and forget to turn it back on before printing their results. Use of menus for input can be coupled with macros to cause an automatic recomputation when the operator selects the print option from the menu.

These and similar program features are included in the QCP's checklist of required program characteristics. There are too many techniques to allow discussion of all of them here. The above techniques will cover a substantial portion of data errors, however. The QCP administrator can determine the methods most appropriate to individual firm and department circumstances.

Misunderstood Data

Misunderstood data can be as harmful to the firm (and to the manager's career) as inaccurate or missing data. Misunderstood reports are often the result of the programmer and the user not communicating with each other. The user documentation requirements discussed in the QCP can help avoid this problem.

V. Summary

Many PC programs generate information used in making decisions that can have a material economic impact on the firm. Their economic impact dictates that there be backup, validation and documentation controls applied to these programs to safeguard the assets of the firm. This paper proposes that critical PC applications be brought into the formal information system of the firm by requiring that program documentation and evidence of validation testing for critical programs be evaluated by the AIS function. AIS would maintain backup software and documentation as well as issue identification codes to those programs meeting company standards.

Use of the identification code procedure allows managers to know whether the data they are using have met firm standards in its production. They have the freedom to use any data source necessary, regardless of potential reliability problems. This preserves the flexibility, timeliness, and economic characteristics that make PC generated reports popular while putting the user on notice of risks involved when the programs creating those reports have not been fully evaluated. The manager also retains control over his/her programmer's output. These factors should make the control package more acceptable to managers.

Several specific techniques that can be applied to spreadsheets, data bases, etc. are presented. Firms that already validate and document their critical PC programs will find the cost of providing that documentation to the QCA administrator is minimal. Firms that do not do this already will face some costs, but will reduce the risk of a disaster by adopting these procedures.

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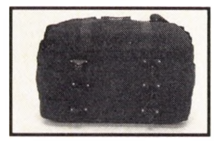

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Accounting Department Retreats

By Mary Anne Gaffney and Bill N. Schwartz

Like many CPA firms and private industrial concerns, accounting departments across the country are holding faculty retreats. Retreats represent one way that accounting departments can set aside a significant portion of time away from the routine of daily pressures to deal with issues of importance to the department.

Through a combined mail and telephone survey, the authors learned of 50 schools who have held retreats recently. The following discussion is based on interviews with the individuals who were in charge of those retreats.

Why Have Departmental Retreats?

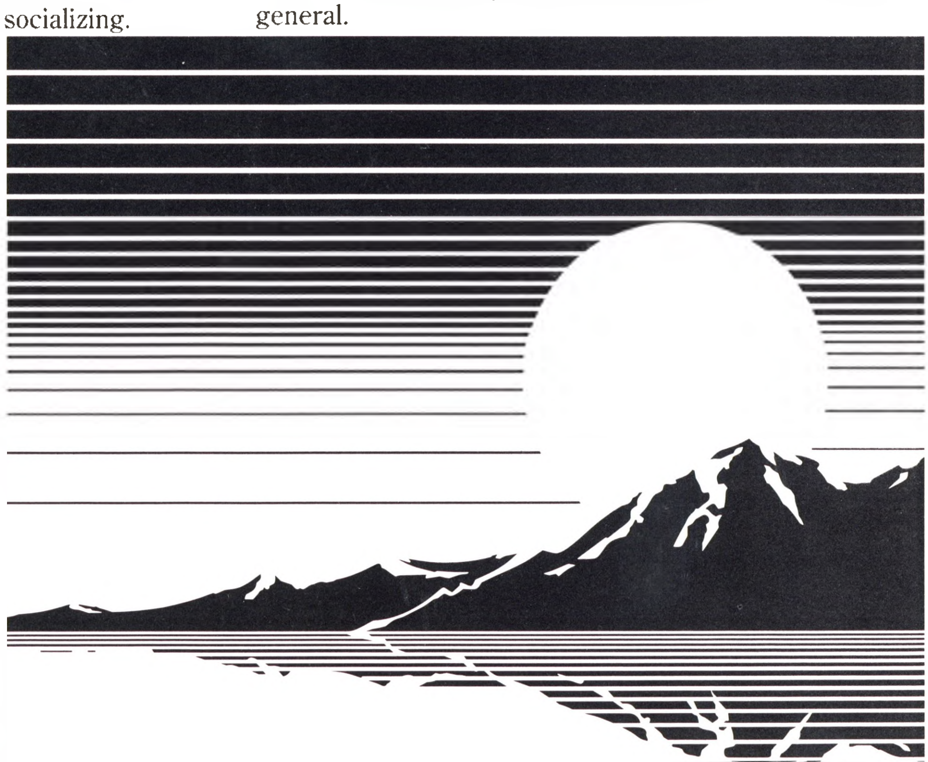
Retreats are an ideal way to increase faculty cohesiveness. Most departments hold their retreats at off-campus locations that provide a pleasant atmosphere. The schedules usually include some time for faculty socializing. Lunches and coffee-breaks are often part of the scheduled activities. Some departments have organized sports as part of the activities. Others conclude their retreats with a dinner and the spouses of the faculty members are invited.

The appointment of a new department head is a major event which leads to many retreats. A retreat gives the new administrator, who is the academic equivalent of a managing partner, a chance to get to know the faculty and to listen to their concerns and differences of opinion in a non-threatening environment.

One of the most important reasons for holding retreats versus the routine department meeting is to provide the opportunity to discuss topics in much greater depth. To facilitate this, most departments have agendas and often distribute a significant amount of pre-retreat reading material. Discussion may be restricted to a few highly sensitive topics or to specific long-range issues such as the 150 hour curriculum design. Some departments even hold one-issue retreats.

For other departments, the retreat is simply a lengthy traditional faculty meeting. A large number of topics may be covered, and faculty votes can be recorded. For these departments the chief reason to hold a retreat is the ability to get the entire accounting faculty together at one time away from the interruptive routine of daily campus pressures and activities.

Respondents generally considered the most successful retreats as those where a limited number of topics were discussed in depth and often centered on long range issues, within the department and business education in general.



Quality Planning is a Key to Success

It is crucial that a department be certain a retreat is needed. A department may need to improve collegiality, conduct long range planning in a setting more conducive to lengthy discussions, or consider some problems that cannot be addressed within the constraints of a routine faculty meeting.

Second, financial support must be available. Most departments pay for their retreats through general fund raising although a few are able to use budgeted departmental funds. Some obtain specific gifts from accounting firms for the event since the latter are aware of the benefits of such retreats.

Third, suitable scheduling must be arranged. A retreat which lasts overnight may be preferred since it leaves more time available for the faculty to meditate on problems as well as time to socialize. During the latter, views are often exchanged in a more relaxed setting that can bring about a consensus when the formal meeting is reconvened. For this reason, if a one-day retreat is scheduled, it is a good idea to provide time for some informal or unstructured activities.

Various times of the year could be considered, depending on the major focus of the retreat. For example, a retreat aimed at collegiality would be particularly appropriate in September when new persons join the faculty. While one might feel September retreats may be too early in the academic year for significant issues to be raised, one should remember that it can be difficult to currently implement solutions reached at end-of-year retreats. For these reasons, October and January were perceived to be good times to hold retreats that focused on either the issue of collegiality or on longer run strategic topics.

Finding an appropriate location is important when planning a retreat. It is best if an off-campus site is available for the retreat. Either university conference centers away from academic facilities or large hotels are good places for retreats. Retreats held in major resort areas may be too distractive for participants.

Good planning generally is facilitated by the preparation and distribution of an agenda before the retreat. The agenda should not contain too many items. Discussions should be scheduled so that sufficient time can be given to hear all opinions and to reach a consensus.

The selection of good discussion leaders is very important for a successful retreat. Different individuals should be used for each topic. Every effort should be made to involve all participants and to avoid having a few dominant persons taking over the discussions. This can be alleviated if the discussion leader is careful to solicit opinions from as many participants as possible.

Finally, feedback from the participants should be sought. Faculty members should be asked to prepare evaluations about each major element of the retreat and to make suggestions to improve future retreats.

Conclusions

Like partners in CPA firms and executives in private industry, accounting faculty often need to step back from their day-to-day activities. They need to get away from their telephones and computers, and take a good look at what they are doing. Retreats offer a forum for airing faculty differences, make an excellent setting to discuss long-range issues, and generally enhance collegiality. To make them successful, a proper environment must be selected, the right date chosen, a sound agenda prepared and capable discussion leaders selected. Most respondents felt that improved departmental cohesiveness resulted from their faculty retreats.

Editor's Note: This article has been greatly condensed. Persons may wish to contact the authors directly for more information about developing a retreat for your firm's personnel or accounting faculty.

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Creating the "Think Time" You Need to Succeed

By Max Messmer

The ability to think is perhaps the most distinctive trait of the human race. Our capacity to reason and take control of our own destiny through careful advance planning is what most sets us apart from other life forms.

But even though we possess this unique talent, most people would admit that they don't have nearly the strategic time they need to think about how to achieve maximum success.

AS an accounting professional, you most likely are increasingly asked to produce more with fewer resources. If you are in public accounting, you may be asked to deliver the same results in fewer hours in order to help your firm remain price competitive.

If you are in corporate accounting, you probably have seen your own department shrink, or at best, remain the same size, while the demands for performance and results continue to increase.

So how do you and your people manage to find time to sit back, clear your mind of scores of immediate tactical problems, and engage in quality thinking time?

While it's essential to carve out time that's removed from distractions in order to do your best thinking, there are other components involved that will determine how well you put that time to use. Here are some elements you might want to consider.

Accumulate Topics in Advance

For most people, the greatest germs of brilliance come at the most inconvenient times for thinking them through. They tend to come as you are sitting in the middle of a meeting which is centered on an entirely different topic, or while taking a shower on a morning when you are running behind in getting to the office or as you are sitting at a restaurant waiting for friends to arrive for an evening of non-business.

You always make a mental note to "save that thought," but by the time you are back at your desk, it has long since been buried by a multitude of other details.

Keep a small note pad or tape recorder with you at all times and get in the habit of recording thoughts immediately. Jotting down ideas as they develop is a technique that the greatest writers and inventors have practiced for centuries.

Unless your thoughts pertain to an action that must be made within a day or two, continue to collect them for at least a week, before setting aside some quiet time to review and develop them. The brain is a marvelous computer that continues to process problems in the background while you are busy doing other things. When you do sit down to study your collection of thoughts, you will find that, together, they create patterns that already form the foundation for new and creative solutions.

Decide When, Where and How You Want to "Think"

The key to effective thinking is to make sure you actually do it, rather than let it continually take a back seat to other pressing matters. A good thought session should be at least one hour in length, with the flexibility to spend more time if needed.

You should plan to have a thought session at least once a week, to step back and examine issues that go beyond daily activities. Make an appointment with yourself to do this. Mark it on your calendar, and do not let minor activities take precedence. Your daily notebook of ideas should provide a meaningful agenda.

Decide where and when you want to do your thinking. Designate a time of day when you are most creative and least pressured. Ideally, this session should not take place in your office, which is too connected to daily details.

If you have access to a conference room, that's usually a good place to close the door and think. If you must use your own office, clear your desk of all daily work materials, instruct someone to hold all calls, turn down the bell on your phone if you can, put a "do not disturb sign" on your door and close it tightly.

If you prefer to hold your "think sessions" at home, observe the same kind of guidelines that remove you from the flow of normal distractions.

Think About How Your People Think

In order to produce their most effective and creative work, your people need to develop the same kind of process for honoring "think time." Once you have developed your own discipline in this area, you will be able to both motivate them by example and guide them by experience in how to do this for themselves.

As you and your people integrate the power of productive "think time" into your individual work schedules, you will find an increase in the desire of the team to attend collective brainstorm sessions. This will open up a whole new dimension of creativity within your professional environment. It might even enable you to achieve the kind of results and productivity that were previously considered unattainable.

Max Messmer *is chairman and CEO of Robert Half International Inc. Its Robert Half and Accountemps divisions specialize in permanent and temporary placement of accounting, bookkeeping, financial and information systems professionals. The company has 160 offices in the U.S., Canada, the U.K. and Europe.*

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Female Accountants & Association Management Companies: Allies in Need?

By David T. Hayhow

Without realizing it, you could be one of probably a hundred women certified public accountants who will face the same professional dilemma today: to serve or not to serve.

See if this scenario is familiar: an established, small or newly-forming association approaches an accountant to help them with their fiscal operations. Shortly after accepting them as a client, the CPA receives a request from an association officer asking her to help the group conduct a board meeting ... send out a newsletter ... train incoming officers, etc.

Since she is not in the business of association management — and has absolutely no desire to enter it — she is faced with an uncomfortable situation: how to avoid assuming the administrative services the organization needs but keep it as a long-term client.

Until recently, accountants facing this dilemma have had very few alternatives. Either they assume responsibilities they do not want — and for which their staff is usually undersized or poorly trained — or they eventually lose the account because either the group disbands due to poor organization or moves to a rival firm that suffers through the extra services needed.

That no longer has to be the case. Women CPAs are finding that there are some situations where a new ally — an association management company — can help them meet their clients' day-to-day operating needs without competing for their fiscal duties.

Association management companies are firms that provide the daily administrative services and special expertise needed to help associations operate. They do this by providing central office facilities and staff that are used by a number of associations on a shared cost basis. So associations are often able to secure better facilities and better trained personnel at a cost that is substantially less than if they create an office and hire full time staff.

Thus, when approached by groups that have unrealistic expectations or demands, accountants find that, in some cases, it is handier to refer their leaders to professional managers while the accountants concentrate on the area for which they and their staffs are best suited.

Though on the surface that might seem like the best of both worlds for everyone concerned, it sometimes is not. In some cases, it is better for the CPA to keep the activity in-house.

If your practice is facing a situation like this, consider the criteria suggested by the Institute of Association Management Companies (IAMC) for professional accounting practices questioning whether to establish cooperative relationships with association management companies. They provide a set of reasonable guidelines for knowing when to go for it and when to let it go.

But first, consider IAMC's general rule of thumb for determining whether a service should be performed in-house or referred to an outside source: it is whether the activity falls within the scope of the traditional professional services offered by a professional accounting practice. In this case, this usually means whatever services fall within the parameters of normal fiscal management, review and operations. In other words, as long as it bears a direct relation to tallying the bottom line or monitoring on-going or special fiscal activities, go for it. If not, refer it to the proper people.

IAMC's criteria for keeping the service in-house:

- The activity is germaine to the fiscal life of the group.
- The activity requires special skills and expertise that are unique to accounting professionals.
- The duties fall within the traditional job roles and experience of junior and support staff. Otherwise, if staff members are not trained in items like meetings management or seminar scheduling, they could easily overlook important details or overpay for services.
- The additional work load is not disruptive to the normal administrative operations of the office. If the services take a disproportionate amount of time or force staff to perform services for which office systems are not equipped — such as multiple bulk mailings or producing and distributing a monthly member newsletter — they can interfere with essential day-to-day office operations.
- The duties do not require long-standing personal and/or professional contacts within the service providers that the accountant and staff must deal with. For example, in order to negotiate the best bulk room rates and meeting facilities schedules and fees, meeting planning specialists often rely on personal and profes-

sional relationships with the hotel/site sales force to strengthen their negotiating position. It is unreasonable to expect staff in an accountant's office to have these long-standing relationships.

- The cost of performing these services is recoverable. Otherwise, in cases where support staff services are included in the CPA's hourly fees, these costs may not be able to be separately billed. If so, an accountant could be losing more in staff time and activity than she nets in her hourly billing rates.

Of course, there are exceptions to every rule. In some cases, it would be better to keep the operations in-house because they require no more than an occasional telephone call or a minimal amount of staff time. If so, a little extra service is the best way to keep a client satisfied and reinforce the perception that he or she has made the right decision in selecting your practice.

In this situation, the accountant's only worry is whether she is setting a dangerous precedent that could evolve into an administrative headache later. This is sometimes a very fine and delicate line.

The best way to find out what you need to know to consider the appropriateness of building a working relationship with an association management company is to contact one or more of the firms in your area and learn more about what they do. You can easily find them in the telephone directory. Or, contact the Institute of Association Management Companies. The Institute has a referral service to help you locate IAMC member companies by specialty as well as geographic location. This will make it easier for your practice to identify the right companies to provide the services and expertise your client organizations need.

Plus, it is a good way to let those companies know of a good female accountant with whom they may want to establish a mutually beneficial relationship.

David T. Hayhow *is president of the Institute of Association Management Companies and chairman of Publicom Association Management Services in Lansing, Michigan.*

Book Review

Megatrends 2000

By John Naisbett and Patricia Aburdene
William Morrow and Company, Inc., New York, 1990, 384 pp., hardback, $21.95
Reviewed by Patti A. Mills, Indiana State University, Terre Haute, IN

In *Megatrends 2000*, the authors' identify and describe "ten new directions" for the 1990's, continuing the trend spotting which they began in the best seller *Megatrends.* To say the least, the book is a great disappointment. It is so fuzzily argued, so full of pablum, platitudes, and hyperbole, that it is hardly worth the reading, much less buying.

Megatrends The Sequel is not so much a guide to the coming decade as a superficial rehash of the recent past. There is very little in its pages that the occasional viewer of "PM Magazine" will not have heard about many times before — The Globalization of the World Economy, The Emergence of Free-Market Socialism, The Rise of the Pacific Rim, The Decade of Women Leaders, The Religious Revival, Cultural Nationalism and so on. All of these topics or trends are treated to the authors' own inimitable brand of "feelgood" or "hot tub" social analysis, in which all (or most all) is considered right with the world and readers are told what they want to hear. The very real problems facing American families, government and business are ignored or barely acknowledged, or labeled as the figment of some doomsayer's fevered imagination. Normally, there is a lot to be said for a positive, upbeat approach, for emphasizing "opportunities" rather than problems. When taken to the lengths in *Megatrends II*, it only serves to distort and mislead, and to retard discussion of important issues.

Nowhere is this effect more pronounced than in the book's feeble — and frankly, irresponsible — discussion of the U.S. economy. According to the authors, America's economic problems are largely a "myth." There is in fact no trade imbalance, and concern over staggering budget deficits and the national debt is so much "hysteria" whipped up by Wall Street and the media. The economy grew in the 1980's and continues to expand in 1990, so why worry? Needless to say, the reader will need to look elsewhere for an informed and intelligent assessment of economic trends. A good place to begin is Benjamin M. Friedman's *Day of Reckoning: The Consequences of American Economic Policy* (Vintage Books, 1989), in which the Harvard economist discusses the fiscal and monetary policies of the last decade and their corrosive effects on capital investment, productivity and America's economic future in general. Don't let the "economist" part put you off: Friedman's account is highly readable, written for more general consumption, and won the Eccles Prize from the Columbia University Business School.

If *Megatrends 2000* has a redeeming feature, it is the author's lively discussion of food, fashion, leisure and the arts and how affluent professionals are spending their money these days. In the inevitable next installment of *Megatrends*, the authors should confine themselves to the lifestyles scene, which they obviously enjoy and know a lot about, and forgo the more serious matters, like economic analysis. It will make for much better reading.

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